Before the

FEDERAL COMMUNICATIONS COMMISSION

In the Matter of	)	
2000 Biennial Regulatory Review--	)	**CC DOCKET No. 00-199**
Comprehensive Review of the	)	
Accounting Requirements and ARMIS	)	
Reporting Requirements for Incumbent	)	
Local Exchange Carriers:	)	
Phase 3	)	
	)	
Amendments to the Uniform System	)	**CC DOCKET No. 97-212**
of Accounts for Interconnection	)	
	)	
Jurisdictional Separations Reform and	)	**CC DOCKET No. 80-286**
Referral to the Federal-State Joint Board	)	
	)	
Local Competition and Broadband	)	**CC DOCKET No. 99-301**
Reporting	)	

INITIAL COMMENTS OF
THE NATIONAL ASSOCIATION OF STATE CONSUMER UTILITY ADVOCATES
CONCERNING CONTINUING PROPERTY RECORDS (CPR)

Pursuant to the Federal Communications Commission's (FCC or Commission) Further Notice of Proposed Rulemaking (FNPRM), as adopted October 11, 2001, and released November 5, 2001, the National Association of State Consumer Utility Advocates (NASUCA) submits these Initial Comments concerning continuing property records (CPR). In doing so, NASUCA reserves the right to reply on other issues raised in the FNPRM.

I. NASUCA'S INTEREST IN THIS PROCEEDING

NASUCA is an association of 42 consumer advocates in 40 states and the District of Columbia. NASUCA's members are designated by the laws of their respective states to represent the interests of utility consumers before state and federal regulators and in the courts.

II. SUMMARY OF NASUCA'S POSITION IN THIS PROCEEDING

Current Commission mandates related to CPR data are more not less important during a transition to market driven competition. Neither in need of elimination nor substantial reduction, the application of CPR requirements are a practical and significant tool in ensuring that the fruits of long held monopoly power do not thwart a transition to full and fair competition.

Furthermore, a series of recent developments underscores the need to maintain and more strictly enforce the CPR mandate rather than streamline or sunset these requirements. First, following the tragic events of September 11th, CPR data should now be valued as a practical and strategic tool in addressing homeland security. In that regard, CPR data is critical for prompt network damage assessment and timely location of replacement parts for network equipment and facilities. CPR data also provides what should be accurate, current and detailed blueprints of network design, vital both for ensuring proper backups (redundancies) and preparing federal and local emergency preparedness plans.

Second, as a result of public, Congressional and media attention focused on the collapse of Enron and Arthur Anderson, there is growing demand for the government to protect against dangers outside the scope of market forces; namely, assurances that adequate accounting standards will be enforced as are crucial to timely investor and public confidence in competitive markets.

Third, as part of its recently announced investigation, the Securities and Exchange

Commission has issued subpoenas to Qwest Communications regarding its accounting practices in recording transfers of certain equipment sales. Even before the Arthur Anderson connection, analysts at Morgan Stanley Dean Witter & Co. had, in 2001, already identified a series of concerns regarding various Qwest accounting practices. This illustrates an ongoing concern: how and when will the Commission use *its* authority to examine those accounting practices as they effect ratepayers and competition?

Fourth, Congress directed the Commission to be a cooperative partner with state regulators during this transition to competition. A recent independent audit of SBC, overseen by California regulators, concluded that SBC's non compliance with various accounting requirements resulted in under reporting of revenues and resulting overcharges to *intra*state ratepayers in California. This recent example of state action illustrates an ongoing concern: when will the Commission systematically determine if violations of accounting requirements including CPR have resulted in *inter*state overcharges, not only in California, but in all states in which SBC conducts its operations? Such determinations are inseparable from USF and other allocations.

III. BACKGROUND

Regional Bell Operating Company (RBOC) subsidiaries are required under 47 C.F. R. § 32.2000(e)(f) of the Uniform System of Accounts to maintain continuing property records that describe all capital equipment, identify its location, reference the equipment's installation work order(s) including date of installation, and identify the equipment's cost. These records must be maintained in such a manner that their accuracy can be checked. Using commonly accepted statistical sampling methodologies, Commission audits sample CPR records and determine

compliance by verifying through a spot-check inspection whether equipment so reported actually exists. 47 C.F.R. 32.2000(5)

Both CPR audits to date have demonstrated serious errors in the CPR submitted by these companies with management under reporting income. Such understatement was the result of *over*stating depreciation (i.e., depreciation of equipment that could not be verified as existing).

IV. DISCUSSION

A. Developments since last fall underscore why CPR must be maintained and in fact strengthened through increased audits by regulatory staff.

Before reviewing the historic and still valid reasons why CPR should be maintained, NASUCA offers examples of recent justifications for CPR requirements.

1. Homeland Security

The tragic events of September 11th highlighted the critical role telecommunications facilities play in national security, whether related to communications necessary for responding to national emergencies, or the need to protect from domestic or international terrorism the national telecommunications network on which our society depends. As so often observed in the wake of September 11th , security concerns arose in every geographic location and every market segment of the nation. The public and the media were not calling out to the Bill Gates and the Ed Whitacres of this country to protect against future incidents or to put in place mechanisms to curtail or respond to future damage. No, they were calling out to *government* authorities to be the leader in both roles.

In the event of massive destruction of some segment of the nation's telecommunications infrastructure, it will be essential for the coordinators of our national response to have prompt centralized access to information as to the location and cost of facilities affected or vulnerable.

CPR data is the sole such source of such information.

At a minimum CPR serves three national security-related purposes.

a. CPR would be critical to damage assessment.

The translation of the codes used in CPR is achieved through a Telcordia database (the OMNI). That translation also provides additional information such as the equipment's manufacturer and various cross references. This is precisely the type of information essential in providing a ready source for prompt identification of what equipment is in which locations as is necessary, for example, in estimating the cost of replacement.

b. CPR would permit timely location of replacement parts for equipment and facilities.

Given the modular nature of outside plant cable and wire, replacement not repair is the economically prudent method for maintaining the network. That is because of the high cost and expertise necessary to repair versus replace. An exception to that otherwise rule is in the event of damage or destruction to portions of the plant necessary to conduct emergency-related communications. In that circumstance repair is the common response to damage. Thus in such an emergency, these continuing property records would make possible quick access to a catalogue of needed replacement parts at other locations that might be promptly transferred to the site of the disaster.

c. For those in government who are responsible for homeland security, CPR should provide an accurate, current and detailed blueprint of the network design.

This factor is perhaps of greatest importance. It is precisely this level of detailed information that is necessary not only to assure proper backups (redundancies) but also to evaluate and prepare emergency preparedness plans for the priority of uses for these facilities

during an emergency.

2. The Collapse of Enron/Arthur Anderson

The collapse of Enron and threatened collapse of Arthur Anderson have forced the public, elected officials and the media to re-examine whether accounting practices and audits are playing their intended role; namely, providing independent and reliable information necessary for substantiation of public policy setting, and for credible analysis of various players and segments of the economy.

3. SEC Investigation of Qwest

Important in that context is the recently announced investigation by the Securities and Exchange Commission (SEC) of certain Qwest accounting practices.[1] Under investigation is a review of transactions involving the sale of certain equipment by Qwest to companies in which it had invested or from which it bought Internet services. Such investigation raises the question of how and whether the Commission is prepared and committed to assume *its* proper companion role in such investigations in order to protect the public.

Whether such investigations are needed is not a theoretical concern. If carriers over or under report income, neither result is in the best interest of ratepayers *or* shareholders for whom accurate reporting of income is a fundamental basis of regulated rates and dividends. Certainly it would appear that the public not only expects such protection from government but would have more confidence in the results of audits conducted by the federal career workforce than by large

[1] *Washington Post*, (on-line edition), March 11, 2002, "Qwest Says SEC Has Questions About Accounting Practices," Steven Bonsteel, *Newsbytes,* Denver, Colorado.

firms.[2] Such results are certainly consistent with growing public concerns about the potential for conflicts of interest in the large accounting firms.

4. CPUC-released audit of SBC

On February 21, 2002, the California Public Utility Commission (CPUC) released the findings of what it characterized as a comprehensive and independent audit that concluded that SBC failed to comply with various accounting and regulatory requirements. As a result, SBC under reported its net operating income by almost $2 **b**illion for the three-year audit period (1997-1999). "The audit addresses only how SBC accounts for its California regulated operations for PUC reporting purposes."[3] Included in the audit was a recommendation that customers be refunded almost $350 million for 1997 and 1998. This state regulatory investigation illustrates a key ratepayer question: is the Commission prepared and committed to assume *its* proper companion role in protecting SBC's *inter*state ratepayers? Will it ensure that SBC'*s inter*state customers nationwide (who comprise nearly half the nation's customer base), were not likewise victimized by such accounting practice violations?

B. Previous justifications for CPR continue, as do the needs it serves.

1. CPR continues to be a vital tool in stimulating fair competition.

A transition from monopoly power to market driven competition does not render the CPR mandate a calcified regulatory relic. Neither in need of elimination nor substantial reduction, the

[2]The *Harris Poll on Confidence/Trust in Institutions* (Jan. 16-21, 2001) includes not only results for that time period, but results as to the same question raised in the previous three years. With respect to measuring in what sectors the public has "a great deal of confidence", those polled in January, 2002, had *twice as much such confidence in the "executive branch of government" than in "major companies*". By contrast, just one year earlier (Jan. 2001), there was no difference. By sharp contrast, in January of 2000 and 1999, confidence was higher in major companies than in the executive branch of government.

[3]CPUC Press Release February 21, 2002

application of CPR requirements is more important than ever, a practical and significant tool in ensuring that the fruits of long held monopoly power do not thwart a transition to full and fair competition.

As observed by Adam Smith,

> Of all the expedients that can well be contrived to stunt the natural growth of a [new colony or nation state's economy], that of the [monopoly] is the most effectual.
>
> ...
>
> The profit of those merchants would be almost equally exorbitant and oppressive.
>
> *An Inquiry into the Nature and Causes of the Wealth of Nations*, Book Four, Chapter 7, *Of Colonies*, (1776) at 248.

At a minimum, RBOCs still enjoy *de facto* monopoly power in the local service market. They should not be allowed to over or under state income in ways that manipulate the market and stifle competition. CPR is a substantive and practical tool for monitoring against such result.

Although CPR is simply consistent with good management practice, NASUCA does not share the assumption embraced in the FNPRM that RBOCs have sufficient incentive to use CPR even without Commission mandate. For in continuing to enjoy many vestiges of their longstanding monopoly market power, the RBOCs illustrate another principle advanced by Adam Smith. Monopoly power is the very enemy of good management.[4]

The Federal Corrupt Practices Act does require RBOC compilation of the data detailed in CPR. But that is not an adequate substitute incentive as is claimed. It lacks the engineering component of physical verification that the equipment carried on the books actually exists.

An incentive to comply with CPR may have existed immediately following passage of the federal Act as RBOCs anticipated competition. But in the past two years that incentive has

[4] Id., Book One, at 63.

diminished or even disappeared. First, the dot com bubble burst. And in its wake available capital dried up in the telecommunications arena just as various competitors were relying on that capital to build out the last mile. It is that last mile that is critical to competitors' survival and to competition.

Putting aside those competitors that failed because of flawed business plans, it is red not black ink that is the predominant color of competitors' books. Incumbents that may have once seen a competitive threat for local service nipping at their heels, know full well that such threat is not remotely imminent.

Investors have a new reason to be wary. The effect of Arthur Anderson lapses is still an unknown.

Thus, a combination of forces rebut the assertion that RBOCs have sufficient incentive to continue CPR practices in the absence of Commission mandate: never enforced CPR requirements; unavailable capital as needed for competition; shaken investor confidence in audit results;and the absence of competition for local service in the vast majority of the country.

2. CPR requirements do not pose an unreasonable economic burden.

There is no credible evidence that CPR poses even a significant let alone unreasonable economic burden on carriers. Regardless of regulatory mandate, CPR-related accounting data as is currently under review, is collected by carriers for other routine business purposes. This is a standard practice throughout the business world. For example, data on capital investment is necessary to track profit margins, make decisions on plant investment and maintenance needs, etc. Though RBOCs may complain about compliance costs in its CPR mandate, the Commission does not specify what record keeping systems may be used, let alone dictate a specific record-

keeping system. Instead it affords each carrier full latitude in creating its own preferred method for achieving CPR's goal: physical verification of the capital equipment booked.

The RBOCs long ago used captive ratepayer monies to pay for the basic format each carrier designed to comply with these CPR accounting procedures. The cost of ongoing collection and reporting is *de minimis*. Thus, there is no substantial burden in providing that same data to the Commission, particularly when such data can now be filed electronically. In any event, the cost savings to the carriers if CPR were eliminated or sharply curtailed is minuscule, especially so in light of the RBOCs' multi billion dollar operations and record profits.

More importantly, any discussion of carriers' claimed economic burden cannot be examined in isolation. It must be balanced with the economic burden to the public and ratepayers if the CPR requirements were *not* in place. Forcing states to gather such data on a case-by-case basis through extensive data requests and spot-check physical verification, is neither practical nor effective for the many important uses such data serves. In the absence of uniformly reported Commission-gathered and physically verified CPR data, state regulators would be deprived of the ability to assess regional comparisons of capital investments. They could not study broader national plant investment trends as industry analysts are likewise able to do when such uniformly gathered data is made available in one location at the Commission.

3. CPR data is necessary for federal *and* state regulators to perform their responsibilities in the transition to competition.

The FPRM concludes that CPR data is largely used only by state regulators. If that be the case, federal regulators are remiss in fulfilling their duty to use and enforce CPR. At the state *and* federal levels, CPR data is a component on which the Commission and state regulators base numerous decisions designed to protect ratepayers, and in so doing, advance the goals of

competition. Commission and state regulators must rely on *accurate* CPR in order to ensure appropriate jurisdictional separations, cost allocations between regulated and unregulated operations, access charge allocations, allowed earnings and rates, and other significant findings.

a. Maintaining CPR is consistent with and critical to the Congressionally mandated federal state partnership in the transition to a competitive market.

Many states do not independently collect such data and spot check physical verification; they simply do not have the resources (and in some instances statutory authority), to do so. This reality was known at the time the federal Act was debated and enacted in 1996. The Act clearly envisioned a partnership between the federal government as the collector and physical verifier of such data, and the state regulators who have a parallel need to use such data. Neither the language of the Act nor its legislative history suggest a Congressional intent to require the states to begin to generate that information independently. The partnership envisioned in the Act and hailed by its Congressional backers, would become increasingly hollow if the Commission shifts that role to the states.

b. To instead rely on individual state ability to solicit such data through proceeding-specific data requests and spot-check physical verification, is sharply at odds with the stated national goal of moving toward a seamless national network so as to better compete globally.

Incumbent providers have long proclaimed that the movement toward global markets is a major impetus for the evolution from cost based regulation to relaxed (price cap) regulation...and ultimate deregulation. That same rationale should compel the maintaining of *federal uniform standards for RBOC reporting and Commission-conducted spot-check physical verification of capital investment*. The stated Congressional goal of a national network is necessary both for

domestic economy needs and our nation's position in that global economy. This was a *federal* Act, assuring a more efficient system than otherwise would be the case with widely varying rules in each state.

4. CPR is also routinely relied upon by state consumer utility advocates and their consultants.

CPR data reflecting assumed accurate capital investment is typically key evidence cited by NASUCA members and their consultants in the representation of the residential ratepayer interest in innumerable proceedings such as those related to Universal Service, Sec. 271 authority, UNE pricing, pole attachment fees, the setting of depreciation rates, revenue requirements, etc. The assumed accuracy of data reported in the continuing property records is used in formulating proxy models necessary for forward-looking pricing models and various cost allocation scenarios. That record serves also as an accounting component necessary to identify whether the rates of noncompetitive services are providing improper subsidies to competitive services as expressly prohibited by Sec. 254 (k) of the Act. Typically it is the captive residential ratepayers NASUCA members represent, who bear the high price of such disallowed subsidies.

Only with such Commission-collected and spot-check-verified data can regulators and consumer advocates ensure that only appropriate costs are included in the definition of Universal Service. For example, carriers must not shift to residential ratepayers more than a reasonable share of the costs of the facilities used to provide such services, including the cost of the loop. That protection was in1996 formally recognized for the first time in the Act. Its goal would be rendered largely meaningless in the absence of CPR rules requiring accurate reporting of capital investment. That goal is further crippled unless CPR is strictly enforced with audits and appropriate fines and penalties for violations.

5. CPR is a prudent government investment in preventing additional legal costs to taxpayers.

When implementing laws enacted by Congress, the Commission must build a record adequate to sustain legal challenges by regulated incumbents that take issue with revenue requirements, cost allocations, etc. Because CPR data is a component in such decisions, having CPR data maintained, including physical spot-check verification, can assist in withstanding legal attacks (e.g., assertions that such decisions result in rates that are unconstitutional confiscation). It is the transparently clear legal strategy of some RBOCs to routinely bring such judicial challenges, that compels a correspondingly defensive strategy by the Commission. Maintaining CPR requirements as part of the record is a prudent investment in minimizing the legal costs incurred in defense of Commission decisions.

C. Commission emphasis should be on enforcement not elimination or streamlining of CPR.

1. Serious problems detected in CPR audits have gone unaddressed.

To date there have only been two such CPR audits[5], both limited in scope, both finding serious levels of noncompliance that resulted in rate overcharges to captive customers. Although

[5]Joint Audit Report on the Basic Property Records of GTE Corporation's Telephone Operating Companies, MBO/AAD 95-24, **Report No. CC 98-6**. **See also, Commission Press Release dated March 18, 1998.**

A CPR audit was then undertaken in 1999 by the Common Carrier Bureau Staff (staff) pursuant to an Order dated February 24, 1999. The scope of that audit encompassed only the hard-wired central office equipment of then RBOCs (Ameritech, Bell Atlantic, BellSouth, Pacific Bell & Nevada Bell, Southwestern Bell, and US West) CC Docket No 99-117 (ASD File No. 99-22). The auditors concluded that the RBOCs had collectively overstated capital investment by more than **$5 billion**. (FCC News Release dated February 25, 1999, Report No. 99-3.). Following rebuttals from the RBOCs, the Commission initiated a Notice of Inquiry inviting comments from interested parties, specifically to ten issues raised by the RBOCs. Of particular importance and weight are those filed by the Attorney General of the State of New York. Unlike commentators including accounting firms such as Arthur Anderson, the Attorney General's office had actually read and reviewed the audit work papers that formed the basis for those conclusions of the Commission audit staff. In Comments filed June 4, 1999, the Attorney General of the State of New York applauded that staff and urged the Commission "to promptly implement" the staff auditors' recommendations "so that rates can be adjusted to reflect reality and any rate adjustments can be passed on to ratepayers, at both state and federal levels."

Commission promises were made that corrective actions would be taken by the carriers, monitored, and then reported on by the Commission, no such report has ever been forthcoming. Thus there can be no basis for confidence that such promised corrective actions were taken, especially since previous serious violations resulted in no fines whatsoever, let alone imposition of other available sanctions.

2. Serious problems detected in CPR audits to date are but the tip of the iceberg.

It is emphasized that given the limited scope of such CPR audits, it is clear they were but the tip of the iceberg. For example, the scope of the CPR audit of 1999 was limited to central office equipment (COE). Auditors were not directed to look at other as large (or even larger) categories of investments (e.g. cable and wire equipment).

3. Other requirements go unexamined, unenforced.

It is noted that the FNPRM is silent on the underlying requirement that such equipment be "used and useful", a requirement under the Uniform System of Accounts. This is but one more example of "tip of the iceberg" considerations. Neither CPR audit ever conducted by the Commission examined whether the equipment being depreciated was in fact used and useful.

While conducting the 1999 CPR audit, Commission staff auditors found equipment not even wired up, let alone being used. Unknown is whether equipment that should have been retired from the books was not, thus allowing ongoing depreciation long after the equipment was idle. Given the enormous changes technology has produced in recent years, it should come as no surprise that large amounts of floor space stand vacant, having been constructed back at a time when equipment required far more space than recently is the case. Regulators entrusted with protecting the public have not determined whether there is compliance with a host of other

accounting requirements of which *used and useful* is but one example.

D. Verizon's recommendations ignore the purpose of CPR.

In the FPRM a response is solicited as to Verizon's recommendations for changes in CPR. Its recommended substitute approach is irrelevant to the intended purpose of CPR. The Verizon recommendation is entirely about the manner in which investment is carried on the books. That is a purely accounting methodology. The public policy purpose CPR is intended to ensure is rooted in the engineering perspective; namely, does the equipment exist? That is a hands-on determination beyond what is "on the books." Whether claimed capital equipment exists is not resolved by looking at the books but rather by spot-check physical verification to ensure that the equipment physically exists rather than being the equivalent of pure vapor found *only* on the books.

V. CONCLUSION

Historic justifications for CPR are strengthened not undercut during this transition from monopoly power to competitive markets. Neither in need of elimination nor substantial reduction, the application of CPR requirements is more important than ever as a practical and significant tool in ensuring that the fruits of long held monopoly power do not thwart a transition to full and fair competition. A series of recent events further underscores the need for the Commission to enforce CPR and conduct more audits rather than streamline or eliminate these very requirements.

Respectfully submitted,

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